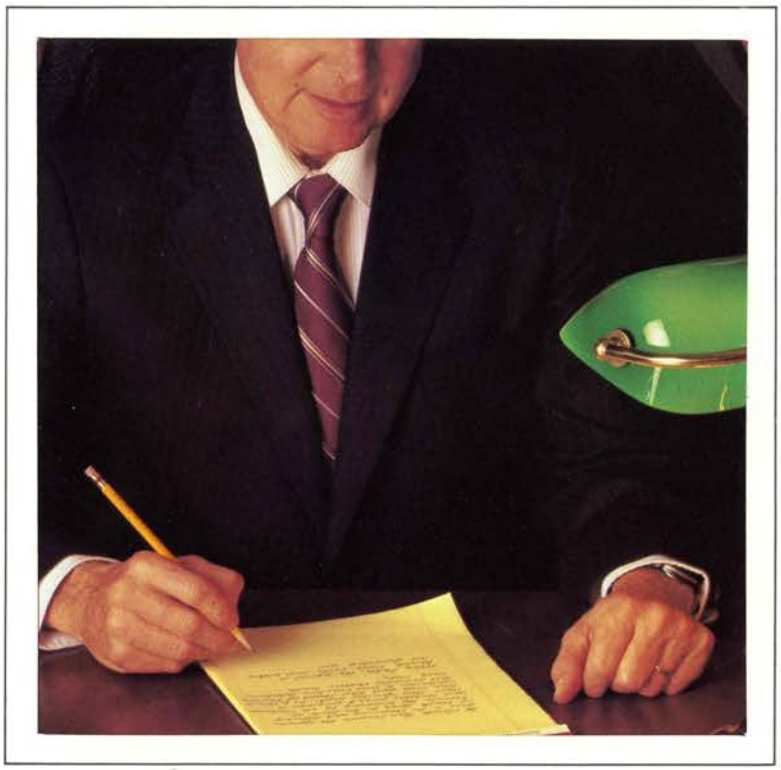
1985 ANNUAL REPORT



"we're taking the pencil to health care costs..."

BLUE CROSS & BLUE SHIELD OF FLORIDA

"... and we're not finished yet." Blue Cross and Blue Shield of Florida is the state's premier health insurer. As a mutual insurance company, it operates for the benefit of its 1.3 million members. The Florida Plan became the dynamic force in the financing and delivery of health care in the state by listening to its customers and tailoring plans and programs to meet their specific needs. As a result, Blue Cross and Blue Shield of Florida continues to find creative solutions that actually reduce health care costs. Health Options, Inc., one of the most important of these solutions, is a wholly owned subsidiary of Blue Cross and Blue Shield of Florida. This network of health maintenance organizations is already serving many group customers and Medicare beneficiaries in the state's major population centers. The Florida Plan is also reducing health care costs through a new statewide network of preferred provider organizations called Preferred Patient Care (PPC). And there are a host of other innovations described throughout this report. Together these proven programs set the standard against which to judge the relative value of any health insurance plan. While primarily viewed in the roles of industry leader and innovator, the Florida Plan also has a very important public service function. Under a cost reimbursement contract with the federal government, Blue Cross and Blue Shield of Florida administers the Medicare program in Florida. Blue Cross and Blue Shield of Florida channels its resources solely for the benefit of its members. Premium dollars are used to pay claims and to administer the business. All revenue not used to pay current claims and operating costs is put back into the business. It is used either to develop new services and programs or to increase the reserves that are used to provide lower costs through rate stability and continued protection for members.

Finding answers to today's health care problems is a demanding challenge. Blue Cross and Blue Shield of Florida is using teamwork to provide the added value that our customers deserve.

Our technical experts are working together to cut health care costs. As a result, we have developed a variety of innovative programs that are described in detail in this report. Still more answers are on the drawing board.

The Florida Plan is committed to offering the highest quality products at the lowest possible price, while continuing to provide superior customer service and the flexibility to meet the complex and changing needs of our customers. Read about our programs and you will see the progress that we have made.

1985 annual report
table of contents

chairman's letter 2

president's report 4

some answers 6

new developments 12

operational review 16

financial review 18

board of directors 26

executive staff 28

A portrait of Blue Cross and Blue Shield of Florida in 1985 is the portrait of a company on the move. Faced with fast - paced marketplace change and guided by one of the finest management teams in the industry, the Florida Plan's strategy is to promote market reform so that the marketplace becomes more efficient and effective. Blue Cross and Blue Shield of Florida has already used change to provide added value to its products, to benefit group and individual customers, to lower prices, to add benefits and to develop new approaches to health care financing and delivery that better meet the needs of today's Floridians.

There has been a variety of causes for change that must be understood to really appreciate the significant advances made by the Florida Plan. Rise in medical costs over time has increased the size of the health care market making it a more attractive industry. At the same time, there has been increased resistance by individual and group customers to rising prices. As a result many new competitors have entered the marketplace in the form of health maintenance organizations and hospital chains. Some of these new entrants have vertically integrated by combining financing with the delivery of services. The growing attractiveness of the health care market has also created an over supply of hospital beds and physicians.

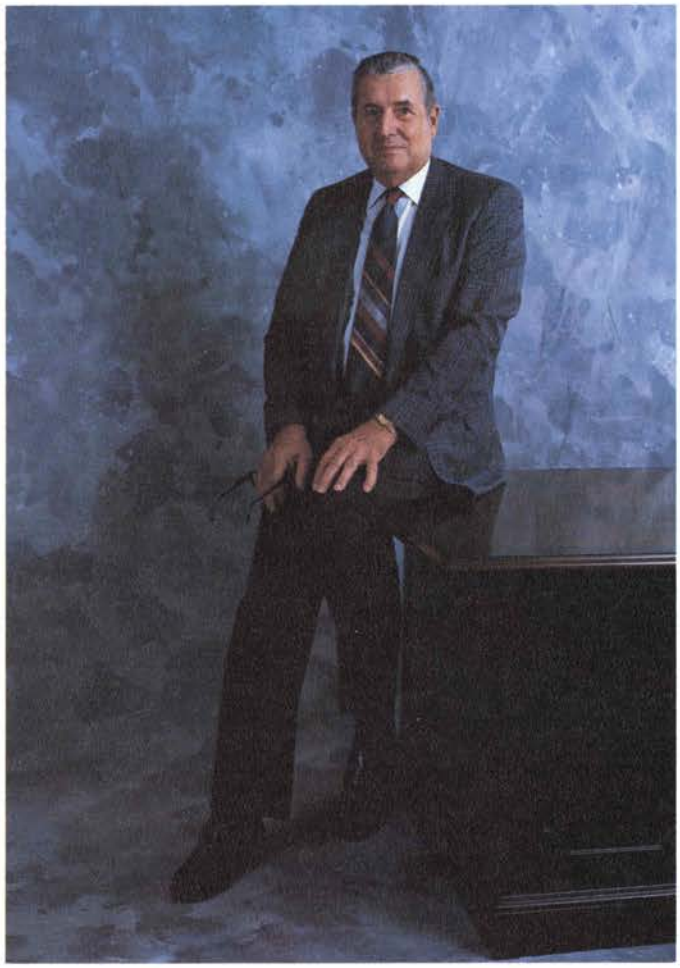
The aging of the population was another cause for change. The elderly population is increasing at a rate of two and one-half times the population as a whole. Floridians over age 65 make up 18 percent of the population, as compared to only 12 percent nationally. The rate of hospital admissions for people over 65 is about three and one-half times as high as for those under 65. And the rise in costs and looming federal deficits will continue to restrict funding under Medicare.

Business and industry are also taking an active role in managing health care costs. Many employers in the business coalitions across Florida have discovered the widely varying costs for essentially the same health care services. These employers began to pressure for change. Employers now have a much greater understanding of what causes the high costs of health care benefits. Increasingly, they are more willing to negotiate directly with providers to obtain cost effective service.

The patient also has begun to assume a new, more active role in selection and use of health services. Consumers are becoming more sophisticated and better educated and they are being given more choices. In ever-growing numbers, they have shown that they would rather have limited access to the health care delivery system than pay for continuing cost increases.

As a result of these marketplace changes, 1985 became a critical year for health care in Florida. The industry found itself in the throes of a revolution. The old system of health care financing and delivery proved unable to meet the needs of Floridians. Changes in medical technology, new treatment techniques and procedures, and the rising costs associated with an inefficient delivery system made the old health care financing and delivery system obsolescent.

Following several years of development, Blue Cross and Blue Shield of Florida found ways to fashion these marketplace changes into benefits for its members. In the process, the Florida Plan has created new health care financing and delivery systems that are equal to a rapidly changing marketplace. Specifically these efforts have been designed to provide incentives to medical professionals and hos-



pitals to control their costs, to encourage members to use their benefits wisely, to obtain the cooperation of the business and medical communities in cost containment, and to promote the development of systems that encourage proper health care utilization. These efforts have had both the direct short term result of saving customers money and the indirect long term impact of encouraging healthier lifestyles.

At Blue Cross and Blue Shield of Florida, we believe that market forces can be effectively used to reshape health care services so that costs can moderate while quality is preserved. By viewing health care as a service that is subject to the influence of supply, demand, and price, we can develop a system that continues to meet the needs of the citizens of Florida.

Preserving the competitive model will allow the Florida Plan to continue to develop the kinds of products and services its subscribers most want and need at the prices they can afford. The challenge of improving the Plan's ability to respond to the needs of its customers will continue to be a major priority of the Board of Directors.

It is a privilege to be associated with a company which combines a long tradition of providing access to quality health care with the prudent application of the efficiencies of American business practice. With this two-edged sword, the Florida Plan will continue to meet its overarching goal of providing quality health care at affordable prices. This is a winning strategy for the health care industry as well as for Blue Cross and Blue Shield of Florida.

On behalf of the Board of Directors,

G. Hunter Gibbons

G. Hunter Gibbons
Chairman of the Board

Even though the health care marketplace experienced intense competition and increasing market fragmentation in 1985, it was a successful year for Blue Cross and Blue Shield of Florida and for its members. It was a year in which the Florida Plan was able to develop creative solutions to customer's demands for better service and more control over the cost of their employee benefits.

The dedicated and hard-working employees of Blue Cross and Blue Shield of Florida answered the challenge of a competitive marketplace with a new sense of vitality and enthusiasm. One result was the development of new programs to capitalize on our changing markets. Another was the continuation of past efforts to improve our operating efficiency and effectiveness. This included adding value to our traditional health insurance through benefits management and by tailoring benefits design to group experience. Since the markets are changing so rapidly and developing new programs and systems to support them is so complex, we have also arranged the company into a number of market segments. In this way, we can develop strategic plans not only for the company as a whole but for each market segment. This accelerates the ability of the company to adapt to changing conditions.

As we begin another year, Blue Cross and Blue Shield of Florida has the most innovative product offerings in the state. These high value and high quality products include: the only state-wide preferred provider organization; a fast developing health maintenance organization (HMO) network; a group of utilization management programs; an HMO alternative to Medicare and supplemental programs; and a traditional health insurance program that has been brought up to date with the addition of three very effective and unique cost containment programs.

While having the right products is important; it is only one of the critical elements behind the added value of our programs. Another key factor is price. Last year we posted a significant victory in the battle against rising costs with the announcement of a major rate reduction in the Plan's Medicare supplemental program, Complementary Coverage, while also increasing benefits. Rates were reduced by an average of 10 percent statewide. This rate reduction equated to $13.5 million in annual premium savings for the more than 250,000 senior citizens insured by the Florida Plan.

In 1985, the Plan experienced a decrease in the use of health care services and a decline in medical inflation. This was largely due to changes in Medicare reimbursement. In Florida, the effect of this change was so pervasive that it made hospitals and physicians aware of the impact of styles of practice on total costs. The Florida Plan has attempted to take advantage of these conditions by developing programs that are further increasing this awareness. As a result, last year the earnings of Blue Cross and Blue Shield of Florida exceeded plans. This meant that the Florida Plan was able to fund the levels of developmental expense required to reposition itself in the marketplace, while still posting a strong financial performance.

While product and price are key elements to success, nothing is more important than a talented workforce.

Ultimately, Blue Cross and Blue Shield of Florida depends on the quality and dedication of its people to meet the challenges of the marketplace. In recognition of their significant accomplishments, Plan management proudly told Floridians about the fine job they have done. Billboards around the city of Jacksonville proclaim, "Our People Find Answers." There is no better compliment one can pay to a workforce faced with such a challenge.

For today and for the immediate future, there is nothing a health insurer can do to gain more than an 18 month competitive advantage. Change will be followed by more change. But Blue Cross and Blue Shield of Florida will continue to use its unique understanding of the needs of its customers to guide change for their benefit. The Florida Plan will be working within the communities and with Member Advisory Councils and with participating providers so that program developments and improvements are based on the inherent needs of each community. Unlike customers of the big national firms, our members will never have to settle for an assembly line approach to health care.

With continued success and increased market share, we at Blue Cross and Blue Shield of Florida will bring even more leverage to bear for the benefit of our customers. We know that the products we have for today are not the answers forever. We will remain relentless in finding even better solutions. We're taking the pencil to health care costs and we're not finished yet.

William E. Flaherty

William E. Flaherty
President

The Florida Plan is taking the pencil to health care costs. Six solid programs are controlling and even cutting costs for group and individual members.

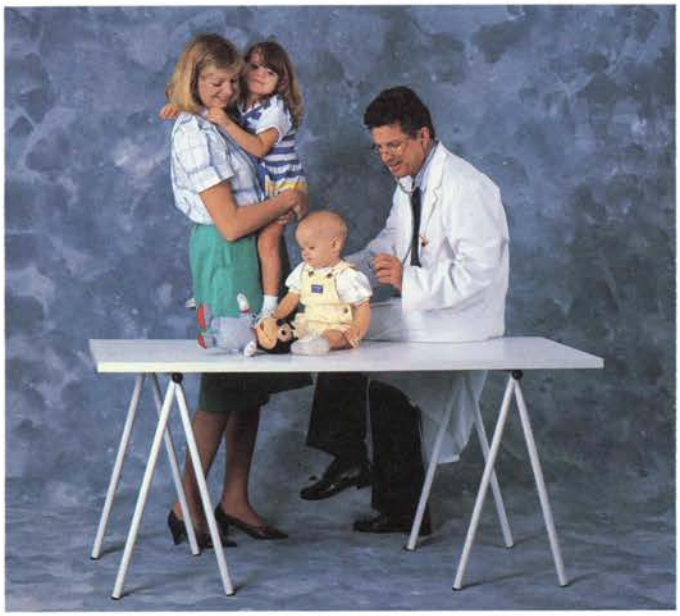
The company's communications early last year asked for patience —"We hear you. And we're working on the answers." It was true, the Florida Plan did not have all the answers. No one did and no one does now. But Blue Cross and Blue Shield of Florida continued to take a hard look at the health care needs and preferences of people throughout Florida. In so doing, it discovered the importance of assuring that new programs are tailored to individual needs of the communities they are meant to serve. By working together with members, the programs that have been developed are making Florida Plan customers the winners in the health care revolution.

The information needed to develop new health care financing and delivery systems came from meetings with customers throughout the state. Member Advisory Councils were expanded to serve as one type of feedback mechanism. Advertisements asking for customer input served as another feedback mechanism. Meetings with reporters, legislators, community leaders, government officials, physicians and hospital administrators were another formal feedback mechanism. And thousands of Florida Plan employees talking with customers at home and at work made "word-of-mouth" into an informal feedback mechanism. By listening to customers, Blue Cross and Blue Shield of Florida discovered the unique concerns of communities throughout the state, then developed programs to meet their special needs.

Blue Cross and Blue Shield of Florida took a giant step in developing the new health care by introducing six solid programs to control, and even cut, the costs of health care for individuals and businesses. These programs include: Health Options, a statewide HMO; the Preferred Patient Care plan for group customers; Medicare and More, the HMO alternative to Medicare and Medicare supplement programs; the new Preferred Patient Care plan for individuals; a traditional health insurance program that has been brought up to date with the addition of three very effective and unique cost containment programs; and a whole series of utilization management programs that are available to groups. Through these programs Blue Cross and Blue Shield of Florida is putting customers back into the health care driver's seat. The Plan is helping Floridians to emerge as winners in the revolution in health care.

Health Options

One of the most significant of these creative solutions is Health Options, Inc., a health maintenance organization network. HMOs have been in existence a long time, but an HMO backed by the quality and integrity of Blue Cross and Blue Shield of Florida is something new and exciting. In the face of rising costs, this is an approach whose time has come. It is an answer to customers' willingness to accept more direct management of their care in exchange for more benefits. Instead of being



Well baby and well child care are regular benefits in the Florida Plan's Health Options and PPC programs.

able to go to any hospital, Health Options subscribers go to the ones that are participating in the program. And these customers use the participating HMO physicians.

With Health Options, physicians coordinate members' medical care. Studies show that these physicians are keeping utilization under control and costs in line while providing quality medical care and a wide range of benefits.

Health Options actually increases benefits while reducing costs. While traditional health insurance merely reimburses customers for covered medical services, Health Options does more. It handles the payment for medical services and also provides the services. This arrangement gives Health Options greater responsibilities for the quality and type of care provided and greater control over health care costs. So Health Options has discovered a way to provide its members with a combination of high quality and low cost health care.

Furthermore, routine medical and preventive care and other benefits not generally covered by traditional health insurance plans are covered by Health Options. Health Options can control costs by controlling both the price and use of services.

Two critical principles of the HMO management concept – preventive medicine and fixed prepaid provider reimbursement – work together to provide financial advantages.

Through the practice of preventive medicine, Health Options' physicians can usually treat an illness before it becomes serious. It is easy to understand the advantages of treating a cold before it becomes pneumonia. By encouraging regular preventive care, the biggest barrier to prevention is eliminated – cost. Office visits, routine health exams, and other preventive services are covered. As a result, members are more likely to seek medical treatment before costly hospital care is required.

The second critical principle, fixed pre-paid provider reimbursement, helps physicians to focus on the cost of services and allows the HMO to budget its costs in advance. Because providers are paid a set amount, they have an economic in-

Alternate delivery systems like Preferred Patient Care and Health Options use high quality, efficient and cost effective providers.

centive to spend prudently. Profit sharing arrangements may also be an integral part of the provider/HMO relationship. By practicing preventive medicine and educating their patients, these physicians are able to ensure better health while reducing hospital usage. This enables them to more easily detect and treat minor illnesses before a crisis occurs. Preserving health through prevention has helped reduce the use of in-patient hospital services.

To assure the very highest quality of services, Health Options' physicians are thoroughly screened before they are accepted into the program. And continued quality is assured through a Peer Review Program. In this program, physicians review each other's work on a regular basis. Health Options also encourages continuing education for its physicians.

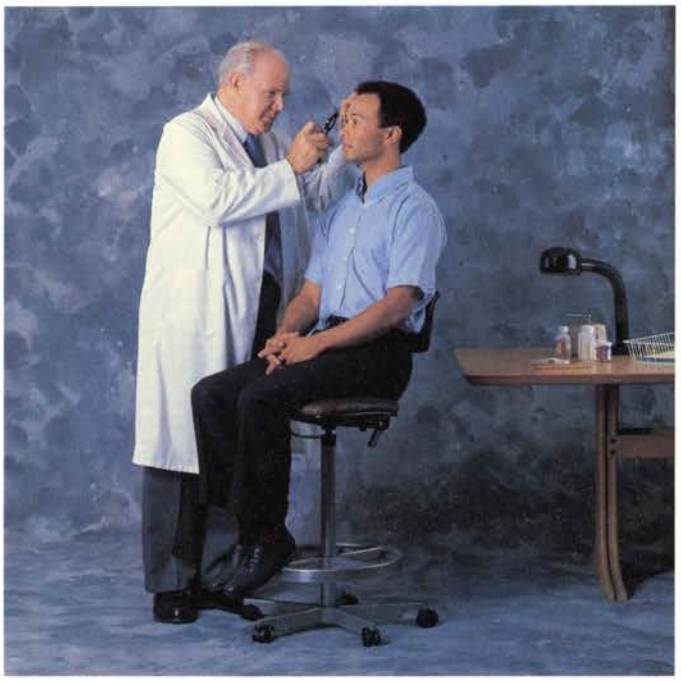
Preferred Patient Care – Group

Preferred Patient Care, or PPC, is another answer to stem the tide of rising health care costs for group customers. PPC is something new, a preferred provider organization. This concept mixes the economic advantages of HMOs with the flexibility of traditional insurance. An HMO's advantages come from selective contracting and organized delivery. Traditional health insurance allows the patient to go to any hospital or provider. With PPC, there are financial incentives to go to preferred providers or hospitals, but patients still have basic insurance if they go elsewhere.

Preferred Patient Care offers flexibility and lower costs because the Florida Plan has contracted with a number of highly efficient and cost-effective physicians and hospitals. They have agreed to provide health care services at pre-determined rates. The rates are generally lower than the fees the providers normally charge and these pre-negotiated rates are accepted as payment in full. One of the advantages Blue Cross and Blue Shield of Florida provides in return for the lower rates is a larger patient volume. The lower cost provides PPC with an economic advantage.

The inappropriate use of health care services is a major cause of rising health care costs. So utilization management programs are used in conjunction with Preferred Patient Care to gain an even greater economic advantage. For example, many times health services can be provided on an outpatient basis, which is less expensive. The PPC physician must obtain a review for certification from the Florida Plan before any elective medical procedure or treatment is performed in a hospital. In this way, the most cost effective setting is chosen for each treatment.

PPC physicians and hospitals are chosen carefully. In each community in which Blue Cross and Blue Shield of Florida has developed a PPC network, the local hospitals were evaluated based on objective criteria. Considerations included perception of quality among the medical community and public, availability of services, location,



The Florida Plan's HMOs practice preventive medicine. Customers receive added benefits like routine vision care, periodic health assessments, immunizations, and innoculation.

availability of beds, and price per case. In order to integrate the hospital and physician components of the program, participating physicians must have admitting or staff privileges in at least one PPC hospital.

Preferred Patient Care – Individual

Preferred Patient Care (PPC) is also an answer to rising health care costs for individual customers. It is one of the most innovative programs available to those not covered by a group. Preferred Patient Care is a high quality and low cost alternative to traditional health insurance. PPC allows people, who might not otherwise afford quality coverage, to obtain the benefits of a comprehensive program.

Each member is provided with a Directory of PPC Physicians and Hospitals for their service area. When members use a PPC physician or hospital, they are responsible only for payment of their deductible, coinsurance if applicable, and for services not covered by their contract.

However, if they do not choose to use a PPC physician or hospital, they are responsible for the deductible and uncovered services as before and also must pay a higher coinsurance rate and any charges which exceed the pre-negotiated PPC rates.

Of course, in an emergency it is not always possible to select a PPC physician or hospital. To protect members from high costs, reasonable reimbursement is allowed for emergency services provided by any non-PPC physician or hospital. The member is only responsible for those costs which exceed the accepted reasonable reimbursement.

Medicare and More

The fourth solid program to answer rising health care costs is Medicare and More. This program is an HMO alternative to the traditional Medicare program and its supplemental plans and is an integral part of the Health Options HMO program. Medicare and More offers all of the benefits of these programs and more.

It provides more comprehensive coverage including: physician office visits, routine health examinations, prescription drugs, and other benefits not fully covered by Medicare.

Medicare and More provides more accessibility to personal physician care than many similar plans.

The Utilization Management programs of the Florida Plan target the most expensive elements of the health care delivery system — hospitalization and inpatient services.

Hundreds of physicians participate in family medical care centers.

This program provides more financial security against high health care costs by eliminating Medicare deductible and coinsurance. This program provides more options in health care protection including a unique conversion option to a Blue Cross and Blue Shield of Florida Medicare supplemental plan.

And finally, Medicare and More provides increased convenience. It is recognized statewide; emergency care is covered 24 hours a day worldwide; and no claim forms are needed.

Medicare and More currently requires a small copayment for office visits. All related laboratory and diagnostic services are covered in full. In addition, there are no claim forms to fill out and there is no need for a Medicare and More enrollee to purchase additional supplemental insurance.

Traditional Plus

The fifth answer to rising health care costs is Traditional Plus. This program for groups provides all the benefits of traditional full coverage insurance plus the advantage of three innovative cost containment programs. The three cost containment programs help employees to play a meaningful role in holding down the cost of their health care coverage. As a result, employees directly benefit from the savings made by mandatory second surgical opinion, preadmission certification and preadmission testing.

Under the Traditional Plus Mandatory Second Surgical Opinion program, two physicians must agree that the subscriber's proposed elective surgery is medically necessary. Otherwise, payment is reduced by 25 percent for all covered hospital and physician charges. This program helps to prevent unnecessary surgery and ensures that the most appropriate setting is chosen for any elective surgery.

Preadmission Certification requires that members receive approval prior to elective admissions. As a result, some procedures, tests, and pre-operative workups may be shifted from an inpatient setting to the less costly outpatient setting. If an elective admission is not certified, the member is responsible for the room and board charges.

The Preadmission Testing program pays 100 percent, less any deductible, for covered pre-operative tests performed on an outpatient basis before a related admission. By performing necessary tests before a subscriber enters the hospital for surgery, length of stay is shortened.

Together these programs make traditional health insurance more affordable. This is an important discovery for controlling costs while assuring high quality.

Utilization Management

Our sixth answer is a whole series of programs called Utilization Management. They include preadmission certification, mandatory second surgical opinion, concurrent review, wellness, and special consulting services.

All screening for the hospital preadmission certification and concurrent review is done using community specific, objective criteria. This allows Blue Cross and Blue Shield of Florida to recognize the difference

Florida's elderly are being offered a variety of innovative choices. The Florida Plan administers the Medicare program in Florida and also has Medicare supplemental programs and even an HMO alternative to Medicare.

between rural and urban settings and the availability and cost of provider services in the community. That way the Florida Plan can provide a more personal response to its subscribers' needs while also reducing costs.

What makes the Utilization Management programs so effective is that they target the most expensive elements of the health care delivery system – hospitalization and inpatient services. They provide a system of checks and balances to assure the most appropriate methods are used. These programs bring physicians and employees into the process in a positive and mutually beneficial way. And they are built around the special needs of each group health care plan.

Obtaining the support and involvement of physicians is critical to the effectiveness of any cost containment program; the Florida Plan's Utilization Management program is no exception. Since physicians influence decisions like where services are performed, when medical care is delivered, how much care is delivered, and how often services are rendered, a systematic approach must be used to ensure their involvement and participation.

Years of experience in dealing with the physician community has yielded innovative and very effective approaches to that process. Blue Cross and Blue Shield of Florida is helping physicians to learn how to better react to market demands for economic accountability. Its programs help physicians to better understand the costs associated with varying levels of care.

The employee is another important link in the Utilization Management program. The employee is brought into the process through an extensive and on-going educational program.

The Future

There are more programs. And others still on the drawing board. The Florida Plan does not have all the answers. But they are finding ways to control the costs, and they are committed to providing the quality coverage businesses and individuals want.

That is the way Blue Cross and Blue Shield of Florida is working to improve health care financing and delivery in Florida. As customers' needs change, the Florida Plan will have the products to meet those needs at prices customers can afford.

Traditional Plus is the answer for groups that want the benefits of traditional insurance with more control of costs.

In finding answers to health care financing and delivery needs of Floridians, Blue Cross and Blue Shield of Florida created new products and improved old ones, expanded new delivery systems, made organizational improvements, and incorporated technological advances. In this section of the report some of the most significant developments for 1985 are described.

Alternate Delivery Systems

During the first quarter, the company's alternate delivery systems division was established as a separate and wholly owned subsidiary called Health Options, Inc. This subsidiary is the parent of all of the Health Options HMO networks with the exception of Capital Health Plan and Health Options of South Florida, which are affiliates.

In 1985, three new Health Options' HMOs located in Orlando, Pensacola and Tampa became operational bringing the total number to six. Three more will become operational in early 1986.

All of the operational HMOs experienced significant enrollment gains in 1985. For instance, Capital Health Plan enrollment increased by more than 40 percent; and Health Options of South Florida experienced more than a 60 percent increase.

There are a number of exciting plans for Health Options for the coming year that should yield even more significant enrollment gains. When completed by the end of 1986, the network will cover 10 major markets. Then, 85 percent of all Floridians will have access to a Blue Cross and Blue Shield of Florida HMO. In addition, the new product, Medicare and More, will continue to be introduced into more markets.

Customer education is important for any new product. A major initiative last year was the implementation of a statewide consumer education campaign for Health Options This campaign highlighted the advantages of Health Options and its ties with Blue Cross and Blue Shield of Florida.

Health Options also added several major accounts during the year. General Motors offered Health Options as the exclusive HMO to its Florida employees and Publix also accepted Health Options' network offering. In a similar development Health Options of Jacksonville was approved for participation in the Federal Employees Health Benefit Program effective for the January 1986 enrollment period.

Preferred Patient Care (PPC), the Blue Cross and Blue Shield of Florida preferred provider organization, also experienced major gains. Last year State of Florida employees gained broader benefits through their involvement with PPC. Their participation also greatly improved the bargaining power of the program and the larger enrollment base is providing additional incentives in negotiations with hospitals and physicians.

While product and price are key elements to success, nothing is more important than a talented workforce. At Blue Cross and Blue Shield of Florida, our people find answers.

At the beginning of the year, PPC had operational networks that covered Dade, Duval, Clay, and Orange Counties. During the course of the year, eleven additional networks were established. These new networks cover St. Johns, Escambia, Osceola, Seminole, Volusia, Broward, Palm Beach, Hillsborough, Pinellas, Indian River and Alachua Counties. In addition, networks are under development in Brevard, Lake, Manatee, Pasco, Martin, Polk, Collier DeSoto, Lee, Marion and Charlotte Counties. When complete the PPC system will provide 95 percent of all Floridians with access to a Blue Cross and Blue Shield of Florida preferred provider organization.

Organizational Improvements

The most significant organizational change last year was the establishment of market segment teams. To make the organization more responsive to customer needs, special teams were set up to address the concerns of our most important market segments. Each team is comprised of executives from marketing, operations, finance, and cost containment. Together they assume the responsibility for corporate-wide performance in a single market.

Dividing strategy and planning into single market segments greatly reduces the complexity of work issues. In addition, these teams provide valuable counsel in the corporate-wide strategic planning efforts. The varying backgrounds and functional accountabilities assure better operational coordination, eliminate internal barriers, and help the organization to become more market-driven.

Technological Advances

The Florida Plan has become a major processor of information and thereby highly dependent upon technology. Computer applications and improvements to information processing are helping Blue Cross and Blue Shield of Florida to increase effectiveness, reduce costs, and provide better services to its customers. A couple of technological initiatives in the systems area that were taken last year warrant special mention because they will yield such important long-term results.

The Florida Plan is committed to developing more innovative and effective answers to meet the emerging health care needs of its customers.

In 1985, Provider Automated Services (PAS), already a national leader in the development and implementation of paperless claims processing, was incorporated as a wholly-owned subsidiary of Blue Cross and Blue Shield of Florida. The PAS subsidiary was established to market data products and services to other Blue Cross and Blue Shield Plans.

Last year, PAS licensed three additional Blue Cross and Blue Shield Plans to market their products and services. This brings the total number of Plans with whom PAS has licensed agreements to 17. In addition, in 1985 PAS sold more than 400 management systems, data entry devices and medical billing computers to hospitals and physicians' offices. Last year, PAS also introduced a new Dental Management System.

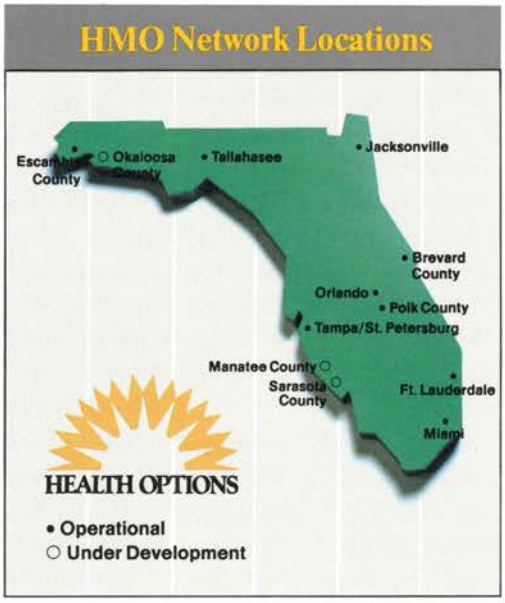
Important systems applications have also been made in the area of utilization management. Automated systems were put into place that support cost containment programs like preadmission certification, hospital stay certification and retrospective monitoring. These systems' applications have enabled the Florida Plan to group these various cost containment initiatives into utilization management programs that are being sold to group clients.

Even small groups get special attention at Blue Cross and Blue Shield of Florida. Programs are available to meet their special needs.

PPC Network Locations

Preferred Patient Care (PPC) established 11 additional networks in 1985. Now 15 PPC networks are in place. Soon, PPC will be available to 95 percent of all Floridians.

HMO Network Locations



Health Options established three new HMOs in 1985. Today the network serves six metropolitan areas in Florida. By the end of 1986, 85 percent of all Floridians will have access to a Florida Plan HMO.

Together our answers form a total program design that is making Florida Plan customers winners in the revolution in health care financing and delivery.

While continuing its past practice of having goals for timeliness and quality of service, the changing marketplace has shown the Florida Plan the need to work with customers to better understand their needs, to validate goals, and to more carefully coordinate these efforts. By keeping the concerns of its customers at the forefront, Blue Cross and Blue Shield of Florida was able to realize important improvements. The result is a total program design that serves customers more fully.

Private Business Operations

Last year a program called "Partners in Quality Change" was also established. It is an effort to bring employees together to manage and control changes for the benefit of customers.

A new processing system was implemented last year to help increase production effectiveness for Federal Employee Program contract holders. In addition, a number of projects were implemented that increase systems flexibility in handling diverse contract requirements, improve the quality of automated patient history records, and provide a more efficient interface between the Complementary Coverage and Medicare claims systems.

Cost Containment Programs

Under the Prospective Charge Payment Program (PCPP), the Florida Plan evaluates hospitals' proposed charge increases by comparing them with projected revenues, anticipated expense and the experience of their peer hospitals. During 1985, proposed increases were reduced by over $19 million as a result of negotiating rates with 247 contracting hospitals. In addition, another $12 million in net recoveries was realized from the Hospital Charge Audit Program. The Hospital Charge Audit program both audits a random sample of each hospital's claims for accuracy and assures that the prices charged are those agreed upon in the PCPP program.

Another cost containment measure that achieved great savings in 1985 was the Other Carrier Liability Program. As a result of this program, savings of $37.7 million were realized in 1985. By identifying the liabilities of other insurers for part or all of a claim before it is paid by the Florida Plan, the company saves costly recovery expenses for employers who elect to participate in this program.

Government Programs

Blue Cross and Blue Shield of Florida also provides services to the Federal government to support the Medicare program. Blue Cross and Blue Shield of Florida is only reimbursed for its costs and makes no profit from these contracts. The Florida Plan was reimbursed a total of $51 million in administrative costs by the Federal government for both Part A and Part B programs in 1985.

The Consolidated Statements of Operation and Policyholders' Equity include these amounts in revenue and operating expense to more clearly reflect the Plan's involvement in the Medicare program. To better understand this change, please review the notes to the financial statements.

In 1985, operations on these government programs

The Florida Plan tailors its programs to each community's individual needs through the input provided by Member Advisory Councils and panels of local providers.

were faced with significant cost constraints. The government made a concerted effort to control the Medicare budget. In addition, the Health Care Financing Administration (HCFA) mandated the implementation of a number of significant program changes and there were major volume increases in Medicare Part A and Part B. In spite of this extremely challenging environment, the company significantly improved its performance and ranking among Medicare contractors.

In fact, last year over 2.4 million Medicare Part A claims were processed. The fine performance was due, in part, to a Medicare Part A data processing system, which was designed and implemented by Florida Plan staff in 1984. During 1985, over 19.3 million Medicare Part B claims were processed.

Financial Effectiveness

Last year, the Florida Plan was able to fund the high levels of developmental expense required to reposition itself in the marketplace, while still posting a strong financial performance.

A contribution to policyholders' equity of $48.6 million was realized from consolidated operations in 1985. The total is composed of $35.8 million in investment income, a gain from operations of $15.5 million, and a $2.8 million decrease in unrealized appreciation of equity securities. The $2.8 million decrease in unrealized appreciation of equity securities results from restructuring and strengthening of the company's investment portfolio. This restructuring also resulted in a sizeable increase of $11.3 million in net realized investment gains. The restructuring was undertaken in anticipation of potential adverse tax consequences in a proposed tax bill which would significantly impede our mission of providing qualiy and affordable health care to Florida residents. In conjunction with the National Association of Blue Cross and Blue Shield Plans, Blue Cross and Blue Shield of Florida is attempting to educate U.S. lawmakers about the detrimental impact such a tax would have on our ability to contain costs and provide quality health care coverage to Florida residents.

At year's end, Blue Cross and Blue Shield of Florida had a policyholder's equity balance of $209.6 million or just in excess of three months' claims and operating expenses. This equity is held to provide continued protection to members during times of economic instability and when utilization of benefits is higher than anticipated and also as a base to enable the Florida Plan to fund innovative cost containment programs and other major initiatives. The equity is invested in stocks, bonds, and treasury securities.

1985 annual report
financial review
table of contents

accountants' report	19
consolidated balance sheets	20
consolidated statements of operations and policyholders equity	21
consolidated statements of changes in financial position	22
notes to consolidated financial statements	23

Blue Cross and Blue Shield of Florida, Inc. and Subsidiaries
Report on Examination of Consolidated Financial Statements
for the years ended December 31, 1985 and 1984

Accountant's Report

To the Board of Directors of
Blue Cross and Blue Shield
of Florida, Inc.:

We have examined the consolidated balance sheets of Blue Cross and Blue Shield of Florida, Inc. and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of operations and policyholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of Blue Cross and Blue Shield of Florida, Inc. and subsidiaries at December 31, 1985 and 1984 and the consolidated results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Jacksonville, Florida
March 6, 1986

Blue Cross and Blue Shield of Florida, Inc. and Subsidiaries
Consolidated Balance Sheets, December 31, 1985 and 1984
(In Thousands of Dollars)

ASSETS	1985	1984
Investments:		
Fixed maturities, at amortized cost (market $53,471 in 1985 and $45,217 in 1984)	$ 51,266	45,896
Equity securities, at market (cost $21,673 in 1985 and $11,287 in 1984)	21,468	13,837
Short-term investments	187,086	128,627
Total investments	259,820	188,360
Cash	1,970	1,615
Interest receivable	4,179	3,966
Reimbursement contracts receivable	70,922	69,162
Receivables	56,753	71,637
Property and equipment	29,060	29,150
Prepaid expenses and other assets	3,835	2,414
Total assets	$426,539	366,304
LIABILITIES		
Liabilities for policyholder benefits:		
Claims outstanding	$ 62,554	68,706
Reimbursement contracts	70,922	69,162
Total liabilities for policyholder benefits	133,476	137,868
Provision for experience rating refunds	2,765	3,170
Unearned premium income and unallocated receipts	27,204	26,076
Deposits and advances	20,308	19,659
Accounts payable and accrued expenses	33,218	18,556
Total liabilities	216,971	205,329
Commitments and litigation (notes 6, 7 and 8)		
POLICYHOLDERS' EQUITY		
Policyholders' equity	209,568	160,975
Total liabilities and policyholders' equity	$426,539	366,304

See accompanying notes to consolidated financial statements.

Blue Cross and Blue Shield of Florida, Inc. and Subsidiaries
Consolidated Statements of Operations and Policyholders' Equity
for the years ended December 31, 1985 and 1984
(In Thousands of Dollars)

	1985	1984
Revenue	$ 779,843	786,976
Claims and medical expense	599,231	598,512
Operating expense (note 2, "Expense Reimbursement")	165,105	135,563
Total expense	764,336	734,075
Operating income	15,507	52,901
Investment income	24,589	20,546
Net realized investment gains (losses)	11,252	(103)
Net income	51,348	73,344
Policyholders' equity, beginning of year	160,975	88,123
Net change in unrealized appreciation of equity securities (note 2, "Investments")	(2,755)	(492)
Policyholders' equity, end of year	$ 209,568	160,975

See accompanying notes to consolidated financial statements.

Blue Cross and Blue Shield of Florida, Inc. and Subsidiaries
Consolidated Statements of Changes in Financial Position
for the years ended December 31, 1985 and 1984
(In Thousands of Dollars)

	1985	1984
Cash provided from operations:		
Net income	$ 51,348	73,344
Items not requiring (providing) cash:		
Depreciation and amortization	5,443	4,267
Net realized (gain) loss on sale of investments	(11,252)	103
	45,539	77,714
Decrease (increase) in certain assets:		
Interest receivable	(213)	(348)
Reimbursement contracts receivable	(1,760)	(9,902)
Receivables	14,884	(15,542)
Prepaid expenses and other assets	(1,421)	995
Increase (decrease) in certain liabilities:		
Liabilities for policyholder benefits	(4,392)	1,153
Provision for experience rating refunds	(405)	1,583
Unearned premium income and unallocated receipts	1,128	732
Accounts payable and accrued expenses	14,662	(4,823)
Deposits and advances	649	702
Cash provided from operations	68,671	52,264
Proceeds from investments sold or matured:		
Fixed maturities	81,957	42,860
Equity securities	20,024	8,750
Total cash provided	170,652	103,874
Cash was used for:		
Cost of investments purchased:		
Fixed maturities	60,582	47,020
Equity securities	43,251	9,365
Short-term investments, net	58,459	41,604
Purchase of property and equipment	5,250	4,318
	167,542	102,307
Net change in unrealized appreciation of equity securities	2,755	492
Total cash used	170,297	102,799
Increase in cash	$ 355	1,075

See accompanying notes to consolidated financial statements.

Blue Cross and Blue Shield of Florida, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 1985 and 1984

1. Organization

Blue Cross and Blue Shield of Florida, Inc. (the Plan), a not-for-profit mutual insurance company, provides basic medical, hospitalization and other health benefits as well as major medical, comprehensive and complementary coverages. The Plan also processes claims for other Blue Cross and Blue Shield Plans' subscribers and for programs such as Medicare and Federal Employees Health Benefits Program (FEP). Through its subsidiaries and affiliates, the Plan operates a network of Health Maintenance Organizations throughout the state of Florida. The Plan is a member of the Blue Cross and Blue Shield Association which establishes national policies and sets standards for the programs.

2. Summary of Significant Accounting Policies

Consolidated Statements

The consolidated financial statements include the accounts of the Plan, its wholly owned subsidiaries and affiliated companies. Intercompany transactions have been eliminated in the consolidated financial statements.

Investments

Fixed maturities are carried at cost adjusted for amortization of premium and discount. No provision has been made for the excess of amortized cost over market value since the Plan generally intends to hold these investments to maturity.

Equity securities are carried at market value. Net unrealized investment losses at December 31, 1985 consist of gross unrealized gains of $268,000 and gross unrealized losses of $473,000.

The schedule below reflects the net changes in the unrealized appreciation of equity securities (000):

	1985	1984
Beginning Balance	$ 2,550	3,042
Net Appreciation (Depreciation) during the current year	8,497	(595)
Less net realized investment gains (losses)	11,252	(103)
Net change in the unrealized appreciation of equity securities	(2,755)	(492)
Ending Balance	$ (205)	2,550

Short-term investments consist of U.S. Treasury bills and notes, repurchase agreements, commercial paper, and other federally insured investments. These investments are stated at amortized cost and mature within two years.

Realized investment gains and losses are calculated on the basis of specific identification at the time securities are sold. The change in unrealized investment gains (losses) of equity securities is recorded in the policyholders' equity account.

Premiums Earned

Premiums are billed in advance of coverage periods and recognized as earned income when due.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets.

(continued)

Liabilities for Policyholder Benefits
The Plan accrues for incurred and unreported claims based on historical paid claims data and experience using actuarially accepted statistical methods. The methods used in determining the liability are periodically reviewed and any adjustment resulting from these reviews is reflected in operations currently. Processing costs related to such claims are expensed as incurred.

The liabilities for reimbursement contracts (National Accounts, Federal Employees Program (FEP) and Cost Plus contracts) are also established as receivables and thus have no effect on net income.

Expense Reimbursement
Operating expenses are allocated to various lines of business in order to determine the expense reimbursement due from Medicare, where the Plan acts as a fiscal intermediary, and also from FEP and other Blue Cross and Blue Shield Plans for which the Plan processes claims. The Plan is reimbursed for either costs incurred or amounts based on predetermined budgets. Reimbursements of $58,606,000 for 1985 and $58,404,000 for 1984 (which approximate the cost of administering these programs) are included in revenue. The actual cost of administration is included in operating expense. Reimbursements and claims payments are subject to audit by the respective agencies and any resulting adjustments are reflected in operations currently.

Pension Plan
The Plan's policy is to fund pension costs accrued which are composed of normal costs and amortization of prior service costs.

Income Taxes
The Plan and its affiliates are not-for-profit corporations exempt from Federal and State income taxes. The Plan's subsidiaries are subject to Federal and State income taxes. At December 31, 1985, these subsidiaries have net operating loss carryforwards aggregating approximately $11,681,000 which can be used to offset future taxable income, if any, through the year 2000.

Allowance for Doubtful Accounts
The Plan provides an allowance for doubtful accounts based upon the expected collectibility of each type of account. Receivables have been reduced by the allowance for doubtful accounts of $5,807,000 and $6,086,000 at December 31, 1985 and 1984, respectively.

Reclassification
Certain reclassifications of 1984 amounts, the most significant of which reflects Medicare program reimbursement as revenue and related expense as operating expense, have been made to conform to the presentation adopted in 1985.

3. Property and Equipment ($000)

	1985	1984
Land	**$ 2,496**	2,179
Buildings	**26,730**	25,988
Leasehold Improvements	**521**	515
Equipment	**24,229**	21,672
Total Property & Equipment	**53,976**	50,354
Less Accumulated Depreciation	**24,916**	21,204
Net Property & Equipment	**$29,060**	29,150

4. Agency contracts
The Plan serves as intermediary for the Medicare program and acts as administrator for the State of Florida - Employee Group Health Self-Insurance Plan. Claims relating to these programs, as shown in the following table, are not reflected in the accompanying consolidated financial statements.

	Number of Claims Processed (000's)	
	1985	1984
Medicare	**21,714**	18,351
State of Florida	**410**	484

	Amount Paid (000's)	
	1985	1984
Medicare	**$4,127,089**	3,854,533
State of Florida	**$ 90,910**	100,274

(continued)

5. Employee Pension Plan

The Plan participates in a defined benefit, non-contributory pension plan for the benefit of all its employees. The pension plan is funded through the Blue Cross and Blue Shield National Retirement Trust, a collective investment trust which services the retirement programs of its participating employers. Pension expense was $808,000 in 1985 and $2,709,000 in 1984. A comparison of accumulated pension plan benefits and pension plan assets for the Plan is presented below ($000):

	January 1	
	1985	1984
Actuarial present value of accumulated plan benefits:		
Vested	$13,494	11,387
Non-vested	846	965
	$14,340	12,352
Net assets available for benefits	$38,539	34,260

The assumed rate of return used in determining the actuarial present value of accumulated pension plan benefits was 9%.

6. Rentals Under Operating Leases

The Plan, its subsidiaries and affiliates lease office space, data processing equipment and automobiles. The leases in effect at December 31, 1985 expire on various dates through 1990. The following is a schedule of future approximate minimum rental payments due under operating leases that have initial or remaining non-cancellable lease terms in excess of one year as of December 31, 1985:

Year Ending December 31	Basic Rental Commitments ($000)
1986	$3,244
1987	2,008
1988	1,104
1989	206
1990	11
	$6,573

Rental expense for 1985 and 1984 was $5,605,000 and $4,182,000, respectively.

7. Health Maintenance Organizations (HMOs)

The Plan has several HMOs in operation throughout Florida. Some HMOs are wholly owned subsidiaries of the Plan while others are controlled by the Plan through a majority of the voting membership or through appointment of the Board of Directors. The Plan has made commitments aggregating $22,500,000 to the operating HMOs of which it has funded $5,150,000.

Approximately $7,500,000 was expensed in 1985 for new HMO development.

The following is condensed financial information of the Plan's operating HMO affiliates and subsidiaries at December 31, 1985 and 1984 and for the years then ended (before eliminations; $000):

	HMOs	
	1985	1984
Total assets	$ 14,720	6,217
Total liabilities	$ 13,032	6,208
Fund balance	1,688	9
Total liabilities and fund balance	$ 14,720	6,217
Revenues	$ 39,031	20,241
Expenses	39,378	20,691
Net Loss	$ (347)	(450)

8. Litigation

The Plan and Blue Cross and Blue Shield of Maryland, Inc. (Maryland) are co-defendants in an action related to claims the Plan processed on behalf of Maryland under the National Accounts Program. The Plaintiff is alleging that the Plan improperly handled certain medical claims and they are seeking unspecified compensatory and punitive damages. The case is still in the discovery stage; however, the Plan's trial counsel is of the opinion that the Plan has meritorious defenses which it will vigorously pursue. Management believes that the ultimate outcome will have no material adverse effect on the Plan's financial position.

Board Of Directors

Chairman of The Board
G. Hunter Gibbons *(4)*
Attorney
Dickenson, O'Riorden, Gibbons, Quale, Shields, and Carlton
Sarasota

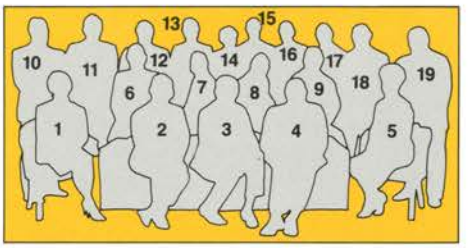
Vice Chairman of The Board
Lewis A. Doman, Jr. *(18)*
President
Citizens and Peoples Bank of Pensacola
Pensacola

President
William E. Flaherty *(3)*
Blue Cross and Blue Shield of Florida, Inc.
Jacksonville

Helen B. Adams *(5)*
President
Fanad Management, Inc.
Orange Park

DuBose Ausley *(7)*
Attorney
Ausley, McMullen, McGehee, Carothers and Proctor
Tallahassee

Edward L. Boykin, C.P.A. *(9)*
Partner
Touche Ross & Company
Tampa



Richard C. Clay, M.D. *(16)*
General Surgeon
Miami

Mary H. Cross *(1)*
Community Affairs Leader
St. Petersburg

S. Hallock du Pont, Jr.* *(6)*
President
Krieghoff Gun Company
Vero Beach

Robert P. Evans *(8)*
Senior Partner (retired)
Evans, Parrish & Fisk
Lakeland

H. Jackson Floyd *(15)*
Retired Executive Director
Memorial Hospital of Sarasota
Sarasota

Victor P. Leavengood *(11)*
Secretary/Treasurer
General Telephone Company
Tampa

Jan B. Luytjes, Ph.D. *(14)*
Professor
Florida International University
Miami

Wallace E. Mathes, Jr. *(13)*
Retired Executive
Consultant to Merrill, Lynch, Pierce, Fenner & Smith
Fernandina Beach

Joseph G. Matthews, M.D. *(2)*
Orthopedic Surgeon
Orlando

Walter S. McLin, III *(12)*
Attorney
McLin, Burnsed, Morrison & Johnson
Leesburg

William V. Roy *(10)*
Retired Executive
Southern Bell Central Florida Division
Orlando

Sherwood D. Smith* *(17)*
Advisor/Consultant to Board
Lakeland

Frederick B. Youngblood* *(19)*
Retired Businessman
Winter Haven

**Board Members until Annual Meeting on September 19, 1985.*

COMMITTEES OF THE BOARD**

Executive Committee

G. Hunter Gibbons, *Chairman*
Helen B. Adams
Edward L. Boykin, CPA
Richard C. Clay, M.D.
Lewis A. Doman, Jr.
Robert P. Evans
Victor P. Leavengood
Joseph G. Matthews, M.D.
William V. Roy

Nominating Committee

William V. Roy, *Chairman*
Richard C. Clay, M.D.
Robert P. Evans
Wallace E. Mathes, Jr.

Personnel and Compensation Committee

Edward L. Boykin, CPA *Chairman*
DuBose Ausley
Wallace E. Mathes, Jr.
Walter S. McLin, III
William V. Roy

Finance Committee

Lewis A. Doman, Jr., *Chairman*
H. Jackson Floyd
Victor P. Leavengood
Wallace E. Mathes, Jr.

Audit Committee

Robert P. Evans, *Chairman*
Edward L. Boykin, CPA
Walter S. McLin, III

Alternative Delivery Systems Committee

Helen B. Adams, *Chairman*
DuBose Ausley
Mary H. Cross
Jan B. Luytjes, Ph.D.
Joseph G. Matthews, M.D.
William V. Roy

Contracting & Cost Containment Committee

Victor P. Leavengood, *Chairman*
Richard C. Clay, M.D.
Mary H. Cross
H. Jackson Floyd
Jan B. Luytjes, Ph.D.
Walter S. McLin, III

***As of September 19, 1985*

Executive Staff

(pictured on page 5)

William E. Flaherty
President

(from left to right)

Charles R. Scott
Senior Vice President,
Health Industry Services

Michael Cascone, Jr.
Executive Vice President

James W. Hart, Jr.
Senior Vice President,
Public Affairs

Harvey J. Matoren
Senior Vice President,
Health Maintenance
Organizations

Robert W. McCaffrey
Senior Vice President,
Marketing

(from left to right)

William H. Dodd
Senior Vice President,
Administration and
Executive Assistant to the
President

James P. Galasso
Senior Vice President,
Finance and Product
Planning

Charles R. Richards
Vice President,
Finance

Antonio J. Favino
Senior Vice President,
Operations

George Cassady
Vice President,
Human Resources

BLUE CROSS AND BLUE SHIELD OF FLORIDA, INC.
532 Riverside Avenue
Post Office Box 1798
Jacksonville, Florida 32231